G-008/GR-95-700

ORDER SETTING INTERIM RATES

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Joel Jacobs	Chair
Tom Burton	Commissioner
Marshall Johnson	Commissioner
Dee Knaak	Commissioner
Don Storm	Commissioner

In the Matter of the Application of Minnegasco, a Division of NorAm Energy Company, for Authority to Increase Natural Gas Rates in Minnesota

ISSUE DATE: October 10, 1995

DOCKET NO. G-008/GR-95-700

ORDER SETTING INTERIM RATES

PROCEDURAL HISTORY

On August 11, 1995, Minnegasco filed a petition seeking a general rate increase of $24,349,000, or approximately 4.2% over existing rates. Minnegasco proposed a projected test year ending September 30, 1996.

Minnegasco also filed a proposed interim rate increase of approximately $18.9 million, or 3.3% above present revenues. Under Minnegasco's proposal, the interim rates would be effective October 1, 1995.

On October 4, 1995, the Commission issued its ORDER ACCEPTING FILING, SUSPENDING RATES, AND REQUIRING FURTHER FILINGS. In that Order the Commission accepted Minnegasco's rate case filing as substantially complete and suspended rates. The Commission also required Minnegasco to file certain supplemental direct testimony.

On October 4, 1995, the Commission also issued its NOTICE AND ORDER FOR HEARING, in which the Commission referred the general rate case to the Office of Administrative Hearings for contested case proceedings.

On October 4, 1995, the Commission met to consider the Company's interim rate petition.

FINDINGS AND CONCLUSIONS

I. THE INTERIM RATE STATUTE

Minn. Stat. § 216B.16, subd. 3 (1994) states in part as follows:

> Unless the commission finds that exigent circumstances exist, the interim rate schedule shall be calculated using the proposed test year cost of capital, rate base, and expenses, except that it shall include: (1) a rate of return on common equity for the utility equal to that authorized by the commission in the utility's most recent rate proceeding;
> (2) rate base or expense items the same in nature and kind as those allowed by a currently effective order of the commission in the utility's most recent rate proceeding;

and (3) no change in the existing rate design.

II. THE COMPANY PROPOSAL

The Company proposed an interim rate increase of approximately $18.9 million, based on the following revenue deficiency calculation:

Rate Base	$354,450,000
Rate of Return	9.76%
Required Operating Income	34,594,000
Net Operating Income	23,535,000
Income Deficiency	11,059,000
Revenue Conversion Factor	1.7056
Revenue Deficiency	$18,862,000

III. THE COMPANY'S MOST RECENT RATE PROCEEDING

Minnegasco filed its most recent general rate case on November 5, 1993, in Docket No. G-008/GR-93-1090. The Commission issued its FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER in that case on October 24, 1994. An annual increase of $8,086,000 was authorized in that Order.

IV. FINANCIAL ISSUES

A. Cash Working Capital

Minnegasco calculated a test year cash working capital requirement of negative $1.297 million for final rates. Although the Company made several test year expense adjustments from the final rate calculations for the interim rate proposal, it did not recalculate the cash working capital requirement. As a result, the cash working capital included for interim rates is not consistent with the cash working capital requirement calculated from the interim schedules.

The Commission will require the Company to incorporate the proper adjustments for cash working capital in interim rates, thus increasing the revenue requirement by $38,000 for the interim.

B. Conservation Costs

Minnegasco proposed recovering its Conservation Improvement Program (CIP) tracker balance of $1,426,216 (as of the beginning of the test year) as a two year amortization, beginning in interim rates.

The Commission finds that a three year amortization for interim rates more closely reflects the Company's prior rate case and thus follows the intent of Minn. Stat. § 216B.16, subd 3. The Commission will require Minnegasco to amortize recovery of the CIP tracker balance over three years for interim rates. This adjustment will reduce test year revenue requirement by approximately $229,000.

The Company did not oppose this modification.

C. Environmental Costs

Minnegasco estimated actual test year environmental expenses of $9.44 million. Because the Company believed these expenses were above normal, it calculated for test year purposes an assumed environmental cost of $4.5 million, plus the excess expense over $4.5 million amortized over two years. For final rates, test year environmental expenses would thus total $6.97 million.

The Commission finds that the excess environmental expense over $4.5 million should be amortized over three years for interim rate purposes. This treatment would be consistent with the amortization period required in prior Commission rate case Orders. It would also be consistent with Minnegasco's interim test year amortization period for its unamortized balance of prior deferred manufactured gas cleanup costs.

This adjustment would reduce test year revenue requirement by approximately $830,000.

Minnegasco accepted the Commission's requirement that the excess environmental expenses be amortized over three years for interim rate purposes.

D. Low Income Discount

In an Order dated December 2, 1994[1], the Commission authorized Minnegasco to defer the costs of implementing its pilot low-income discount program, and allowed carrying charges to be applied at the Company's rate of return.

In its rate case filing, Minnegasco included $765,372 in test year costs for the low-income discount, and $323,000 in rate base for the pre-test year deferral balance. The Company proposed amortizing the pre-test year balance over two years for interim rates.

Because the Commission has previously required three-year amortizations of other deferral

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[1] In the Matter of a Low-Income Residential Pilot Program for Minnegasco, Docket No. G-008/CI-94-675, ORDER ADOPTING PILOT PROGRAM AND REQUIRING FURTHER FILINGS.

balances for interim rate purposes, the Commission will require Minnegasco to amortize the discount program balance over three years for interim rates. This adjustment will decrease the test year revenue requirement by approximately $69,000. The Company has agreed to the three-year amortization and the related revenue adjustment.

The Commission also notes that the low-income discount costs arise from a new program and are thus not "the same in nature and kind" as those allowed in the Company's last rate case. Under Minn. Stat. § 216B.16, subd. 3 (1994), these expenses are not properly included in interim rates unless the Commission finds that exigent circumstances warrant their inclusion.

In this case, the Commission finds that exigent circumstances justify inclusion of the low-income discount costs in interim rates. The Commission was directed by the Minnesota legislature to order a pilot low-income discount program for one utility; Minnegasco's program was that pilot. Minn. Stat. § 216B.16, subd. 15. This unique circumstance calls for special consideration of the program's expenses. Also, costs of this program will continue to accrue throughout the rate case proceedings; recovery in interim rates will provide fewer adjustments and simpler calculations in final rate determinations.

E. Commission Action

The Commission will order Minnegasco to make the adjustments to its interim rates calculations described above. The total adjustments will reduce Minnegasco's proposed interim increase from $18,862,000, or approximately 3.3%, to $17,772,000, or approximately 3.12%.

V. CAPITALIZATION AND COST OF CAPITAL

Minnegasco proposed using the following capital structure and cost rates for interim rates:

Type of Capital	Ratio	Cost	Weighted Cost
Long-term debt	49.94%	8.70%	4.34%
Short-term debt	1.90%	6.40%	0.12%
Common equity	48.16%	11.00%	5.30%
			9.76%

In Minnegasco's last general rate case, the following capital structure and cost rates were set:

Type of Capital	Ratio	Cost	Weighted Cost
Long-term Debt	49.00%	8.53%	4.18%
Short-term Debt	2.40%	6.00%	0.14%
Common Equity	48.60%	11.00%	5.35%
			9.67%

Minnegasco is thus using the same cost of common equity as allowed in its last rate case and the same capital structure as the Company proposed in this rate case. The Company's proposed capitalization and cost of capital for interim rates are consistent with the interim rate statute.

VI. RATE DESIGN

A. The Company's Proposal

Minnegasco proposed applying the same interim percentage increase to all customer classes, with one exception: Minnegasco would exempt from the interim rate increase its customers who are under the "flexible tariff" rates allowed under Minn. Stat. § 216B.163. Because these customers are subject to "effective competition," the Company stated, their rates are market-driven; they should not be subject to a cost-based increase.

Flexible tariff customers have negotiated price based upon the rates of competitive fuels in the marketplace or the customer's ability to "bypass" Minnegasco. Because price for these customers has been negotiated and agreed to, Minnegasco argued, exigent circumstances exist to warrant their exemption from interim rate increases. If subjected to an interim rate increase, the market rate customers could either refuse to pay the increase, turn to alternative fuel sources, or bypass Minnegasco completely. If the customers did not pay the increase, Minnegasco would suffer the loss of revenue. If the customers turned to alternative fuel or bypass, they would be lost to the system and other ratepayers would lose the benefit of their contribution to fixed costs.

B. Commission Action

1. Introduction

Minn. Stat. § 216B.16, subd. 3 requires that existing rate design remain unchanged for interim rates, unless the Commission finds that exigent circumstances exist. The Commission must determine if Minnegasco made a sufficient showing of exigent circumstances to justify its proposed departure from previous rate design. If the Company has shown exigent circumstances, the Commission must then decide the proper rate design for the flexible rate class of customers.

2. Exigent Circumstances

In adopting the flexible tariff statute, Minn. Stat. § 216B.163, the Minnesota legislature recognized that energy utilities will sometimes need to meet competitive situations with rate design tools not found in classic cost of service regulation. When dealing with customers who are capable of burning alternative fuels or bypassing the utility, the utility may seek approval of a flexible range of prices with which to meet varying market prices. Because the utility must negotiate price in order to win contracts with customers who are capable of leaving the system, the statute provides that the rate may recover incremental cost alone, without contributing to fixed costs.

In Minnegasco's 1992 and 1993 rate cases, the Company's ongoing flexible rate contracts received traditional cost of service ratemaking treatment in interim rates. In neither case did the Commission find that exigent circumstances warranted a change in rate design. Minnegasco was required to impose the same interim increase on all customer classes, including the market rate customer class. Rather than risk the loss of its flexible tariff customers, the Company chose not to collect the increase from them, thereby absorbing the loss of their share of revenue contribution.

In the 1992 Peoples Natural Gas Company rate case[2], the utility *was* allowed to exempt its market rate customers from the interim rate increase. In that case the Commission found that the utility's need to meet the market rate for its large customers, who were capable of bypassing the system, constituted exigent circumstances justifying a change in rate design. The Commission noted that a greater need for flexibility arose from the increasingly competitive nature of the gas utility industry. At p. 3 of the May 29, 1992, ORDER SETTING INTERIM RATES, the Commission stated:

> Equally clearly, bypassing Peoples is a realistic alternative for large volume customers. The growth of transportation service and the loosening of wholesale price regulation has made buying and transporting their own gas supplies attractive to many large volume customers. This is especially true of the taconites, which operate in a highly competitive international market.

In the present case, the Commission finds that Minnegasco has made a sufficient showing of exigent circumstances to justify a change in rate design for its market rate customers. The fact that the Company has twice reluctantly absorbed the interim price increase rather than apply it to these customers is evidence of the risk the Company perceives. Requiring Minnegasco to absorb an increase it considers uncollectible conflicts with a major goal of interim rate proceedings: keeping a utility whole while final rates are determined.

The Commission is aware that Minnegasco plans an increase for market rate customers in final rates. This fact is in contrast to the Peoples rate case, in which the utility did not contemplate any increase for its large volume customers. Minnegasco explained that it did expect to be able to get "some" increase from its market rate customers when final rates are in effect. At that time, the Company will be in a position to negotiate each flexible rate contract as it comes due, with an eye to achieving the overall percentage increase the Commission allows. The Company did not believe that it could recover the increase in the relatively short interim rate period, when the interim increase is a set percentage applied to each market rate customer's bill.

For these reasons, the Commission finds that exigent circumstances justify a departure from prior rate design for Minnegasco's market rate customers. The Commission must then decide the proper rate design to apply to this class of customers.

3. Proper Rate Design for Minnegasco's Market Rate Customers

While the Commission finds that exigent circumstances justify a departure from past rate design for these market rate customers, the Commission is reluctant to accept Minnegasco's proposal of *totally* exempting the customers from an interim rate increase. The Company plans a rate increase for market rate customers in final rates, and has stated that it should be able to recover "some" increase from these customers. The Commission finds, therefore, that the increase for market rate customers should be something more than 0%.

The Commission will set the interim rate increase for Minnegasco's market rate customers at

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[2] In the Matter of the Application of Peoples Natural Gas Company, a Division of UtiliCorp United, Inc., for Authority to Increase Its Rates for Natural Gas Service in the State of Minnesota, Docket No. G-011/GR-92-132.

1%. This percentage acknowledges that Minnegasco should be able to recover "some" increase from these customers, while retaining the special treatment warranted by the exigent circumstances of this case. A 1% interim increase should minimize Minnegasco's risk of losing its market rate customers, or being forced to absorb their share of increase, while also mitigating the burden which falls to other customer classes. In the particular circumstances of this rate case, the Commission finds that a 1% interim increase properly balances the concepts of cost of service ratemaking, which still form the framework of utility regulation, with the realities of an increasingly competitive environment.

C. Conclusion

The total dollar amount of the interim rate increase ($17,772,000) is approximately 3.12% of test year revenue under current rates.

The Commission has authorized Minnegasco to apply a 1% interim rate increase to its Market-Based, Flexible Rate customers. This departure from across-the-board rate design affects the increase for other customer classes. The interim rate increase for Residential, C&I, Dual Fuel, and Transport customers is 3.127%.

VII. EFFECTIVE DATE OF THE INTERIM RATE INCREASE

A. The Company Proposal

Minnegasco proposed that the interim rate increase go into effect on October 1, 1995, which is less than the full 60 days allowed under the interim rate statute. Minnegasco stated that it had originally intended to submit its rate case filing on August 2, 1995, with a proposed interim rate effective date of October 1 (60 days after the filing). In order to incorporate recent information from the Minnesota Pollution Control Agency regarding manufactured gas cleanup, the Company delayed the filing date to August 11, 1995. Minnegasco nevertheless asked the Commission to count the statutory 60 days for interim rates from the originally scheduled filing date of August 2, making the effective date October 1.

B. Commission Action

Minn. Stat. § 216B.16, subd. 3 requires the Commission to order an interim rate schedule into effect not later than 60 days after the initial filing date. Because the Commission must examine lengthy and complex utility filings before determining interim rates, it has traditionally allowed the entire 60 days before interim rates go into effect.

The Commission will allow interim rates to go into effect for service rendered on and after October 10, 1995 (60 days after the Company's August 11, 1995 filing date).

At the October 4, 1995, hearing, the Company did not oppose this requirement.

VIII. CUSTOMER BILLING

A. The Company's Proposal

Minnegasco proposed that the interim rate increase be applied to the following billing components on the customer's bill: Basic Charge, Delivery Charge, and the Base Cost of Gas. The percentage increase would *not* be applied to the Purchased Gas Adjustment (PGA).

The PGA is included in the cost of gas for billing purposes. Application of the interim rate percentage to the entire cost of gas would therefore not be accurate.

To avoid customer confusion, Minnegasco proposed including the interim increase on bills as a dollar amount rather than a percentage. The bill would contain the information that the PGA is included in the cost of gas.

B. Commission Action

The Commission finds that the percentage increase applied for interim rates is important information which should not be excluded from customer bills. Customers should be able to track the effect of the interim and final rate changes on their bills. If customers are provided with sufficient information, they should be able to subtract the dollar amount of the PGA adjustment from their billing subtotal, then multiply that number by the interim rate percentage to determine the dollar amount of the increase.

The Commission will require Minnegasco to continue showing the percentage of the rate increase on customer bills, with an explanation of how the dollar amount of the increase was calculated.

At the October 4, 1995, hearing, Minnegasco expressed agreement with this requirement.

IX. OFFSETTING THE INTERIM RATE REFUND

A. The Company's Proposal

Minnegasco proposed reducing an eventual interim rate refund, if any, by the remaining unamortized balance in the rate case expense account and the unrecovered balance in the CIP tracker account.

B. Commission Action

Consideration of rate case refunds would be premature in an interim rates determination. If Minnegasco wishes the Commission to address offsets to a rate case refund, it must raise this issue in the general rate case proceeding.

At the October 4 hearing, the Company agreed to defer consideration of this proposal.

X. INTERIM TARIFF SHEETS AND NOTICE TO CUSTOMERS; COMPLIANCE FILINGS

The Company will be required to file revised interim tariff sheets within seven days of this Order and to include a Staff-approved notice of the rate change under the interim rate schedule that will be included with each customer's first bill. In addition, after the Company has provided notice to its customers as described herein, the Company shall certify its action to the Commission.

XI. SUMMARY OF COMMISSION ACTION

Based on the findings and conclusions above, the Commission authorizes an interim rate increase of $17,772,000, or approximately 3.12%, for Minnegasco, effective October 10, 1995.

Interim rates are collected subject to refund in the event the interim rate level exceeds the final rate level allowed in the general rate case. Minn. Stat. § 216B.16, subd. 3 (1994).

ORDER

1. Minnegasco is authorized to collect $17,772,000 in additional annual revenues, or approximately 3.12 percent of revenues under current rates. The interim rate schedule will be effective for service rendered on and after October 10, 1995.

2. Minnegasco's interim rate proposal is approved, with the modifications to financial items and rate design set out in Sections IV and VI of this Order.

3. Minnegasco shall assess all of its customers an equal 3.127 percent increase for interim rates, with the exception of its flexible rate customers, who shall be assessed an interim increase of one percent.

4. Interim rates shall go into effect for service rendered on and after October 10, 1995.

5. Minnegasco shall continue to show the percentage amount of the interim rate increase on customer bills and an explanation of how the dollar amount of the increase was calculated.

6. Within seven days of the date of this Order, the Company shall file with the Commission and the Department of Public Service interim tariff sheets and supporting documentation reflecting the decisions herein. The Company's filing shall include a proposed notice to customers, approved by the Executive Secretary, regarding the rate change under the interim rate schedule.

7. The Company shall keep such records of sales and collections under interim rates as will be necessary to compute a potential refund. Any refund shall be made within 120 days of the effective date of the Commission's final Order in a manner approved by the Commission.

8. The Company shall include with each customer's first bill under the interim rate schedule a notice of the rate change, approved by the Executive Secretary. Upon completion of this task, the Company shall certify this fact to the Commission.

9. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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